Current PCI	50.0000
Gross Domestic Product Price Index	3.00%
X = Productivity Factor	6.50%
GDPPI – X (3 - 6.5)	-3.50%
Exogenous Factor[20]	0.00%
50 x -3.50%	-1.75
Proposed PCI (50 - 1.75)	48.2500

Impact to Basket Revenue

Basket Revenue at Current PCI	$2,000
Current PCI	50.0000
Proposed PCI	48.2500
Proposed Revenue at Proposed PCI	$1,930

In the foregoing hypothetical price cap basket, the prices for multiple services in the basket will be set in order to generate revenues of $1,930.

2. Cost data is unnecessary under price regulation.

As the above example and Chart 2 clearly illustrate, the inputs into the price cap process do not rely on the results of the cost assignment rules. Unlike the rate-of-return example, when a LEC's costs, and specifically the results of the cost assignment rules, are a critical input that has a direct and meaningful impact on the rates that customers pay, the inputs into the price cap process are governed by economic factors such as productivity and demand. The significant policy realignment from rate-of-return regulation to price cap regulation at both the federal and state levels effectively severed the direct link that was inherent in rate-of-return regulation between carriers' costs and prices for services. In fact, a price cap LEC benefits by keeping

[20] The Exogenous Factor represents costs outside the carrier's control. The Factor can be either a plus or a minus; for example, changes in tax laws could trigger an exogenous adjustment. The adjustment is expressed as a factor representing the adjustment amount divided by the current basket revenue.

costs low (and productivity high) so as to maximize its returns. In short, the shift to price cap regulation fundamentally has obviated the need for the Commission's cost assignment rules.

ATTACHMENT 4

State Regulation

The following Appendix provides summaries of state price regulation plans for each of the AT&T ILECs requesting relief in this Petition. As noted in the Petition, each of these states had the foresight to recognize that rate making for intrastate services was better served through the implementation of incentive regulation. Price caps plans were implemented as a transition to market based pricing while competition further developed.

During the early to mid-1990s, each of the states replaced rate-of-return regulation with price cap regulation that is very similar to the price cap plan the Commission implemented for interstate rates.[1] These plans, like the Commission's plan no longer rely on cost information or rate of return for ratemaking purposes, but instead regulate prices or, increasingly, allow the market to do so. Thus, state commissions no longer rely on, use, or even need the information that is generated by the rate of return rules.[2]

Arkansas

The price cap plan, with no regulatory review, was established by legislation February 4, 1997 (Sen. Bell 54-Act 77) and does not expire. After a three-year cap, basic local and switched, rates may be increased annually based on price cap formula (75% GDPPI plus or minus exogenous factor).

Pricing flexibility is in effect for all other services. Additionally, after the three-year cap, the law requires the Arkansas PSC to forbear from rate regulation of basic local exchange and switched access rates in any exchange where another telecommunications provider is providing basic local exchange or switched access service. The Arkansas PSC cannot require filing of any report, statement for reviewing, monitoring of regulatory earnings, ROR or conduct any investigation.

Rates may be increased or decreased by filing a tariff or price list with the PSC, approval is not required. Rates for any service not classified as a telecommunications service are not regulated and need not be filed with the PSC.

---

[1] As in the Commission's plan, all of the states in AT&T's region are under incentive regulation plans with no sharing and no LFAM capabilities.

[2] As noted in the summaries below, even though none of the states in AT&T's region are under rate-of-return regulation, 5 states file some intrastate cost information – Connecticut, Illinois, Nevada, Texas, and Wisconsin. AT&T can meet these requirements internally without the Commission mandating AT&T follow its cost allocation or separations rules. Indeed, the information to be filed can be gathered through targeted and specific analysis and the need for a structured process as is required for compliance with Part 64 and Part 36 rules is unnecessary. AT&T will continue to meet these states' reporting requirements through these internal means.

Promotions and packages are allowed with or without a discount and can include affiliate services with a notification letter filed with the PSC. Promotions lasting longer than 91 days or more are available for resale to CLECs and the additional wholesale discount will be applied in addition to the promotions discount.

GAAP authorized depreciation rates are authorized for price cap companies. As well as, exogenous treatment, but no low end option.

The PSC retains full regulatory authority over quality of service standards, treatment of customers, collection practices, billing, service intervals, etc. They can monitor and take any action deemed necessary to assure overall quality.

California

Pacific Bell's first alternative regulatory plan became effective in 1990 and was reviewed every 3 years by the Commission. The plan was a modified price regulation plan which, when initially developed included provisions for earnings sharing, and annual price indexing adjustments based on inflation net of productivity offsets ± exogenous cost changes (Z-factors). Regulatory product categories were established for purposes of setting rules for pricing flexibility. Services are, in general, offered through CPUC approved tariffs under California law. Annual price indexing adjustments for inflation and productivity were suspended by the Commission effective January 1, 1996. Sharing provisions were suspended effective January 1, 1999. The definitions of costs qualifying for exogenous factor treatment were also narrowed effective January 1, 1999 prompting the Commission to rename them as Limited Exogenous or LE-factors.

On August 24, 2006, the California Public Utilities Commission adopted its Uniform Regulatory Framework (URF). The URF Decision implements significant regulatory reforms reflective of the competitive communications market place in California.

Full pricing freedom is allowed for all business retail services, non-basic residential retail services, competitive local exchange carriers are required to provide 30-day notice to customers of any proposed price increase, but price increases go into effect the day after they are filed with the PUC.

Although the Commission recognized that market competition sufficiently checks landline phone companies' pricing power, the Commission's URF Decision maintains current basic residential rates for phone service at current levels until Jan. 1, 2009, as these rates are linked to social policy programs, which are currently under Commission review.

The degree of pricing flexibility to be granted for intrastate private line and special access services will be determined in Phase 2 of the URF proceeding.

In addition to new pricing flexibility the URF Decision also eliminates numerous obsolete and now meaningless vestiges of earlier regulatory frameworks, such as: unique CPUC mandated accounting and affiliate transaction rules; earnings sharing mechanisms; and other onerous monitoring reporting and auditing requirements.

Connecticut

A modified price regulation plan was adopted by the DPUC on 3/13/1996 (Public Act 94-83, DPUC Docket No. 95-03-01 [decisions 3/13/96, 6/25/97 and 11/25/98], and Public Act 99-222). The plan was effective in Connecticut April 1, 1996. After an initial five-year monitoring period (April 1, 2001) and an additional three-year period, the plan continues until the Commission (DPUC) or company files to reopen the proceeding.

Pricing flexibility was extended to services in the Noncompetitive, Emerging Competitive, and Competitive categories with price changes permitted within bands. TSLRIC cost was designated as the recommended price floor for all noncompetitive services. The price floor for emerging competitive and competitive services was set by state statute to be the imputation standard.

Services with rates found to be below cost, e.g. residential local exchange are exempt from the application of the formula, except for the Q factor. For other local exchange services, e.g. business and home office, the annual change resulting from the price cap adjustment is applied to the company's depreciation reserve deficiency rather than being used to reduce those rates.

The Alternative Regulation plan included a price cap formula to be applied to noncompetitive services. The DPUC excluded competitive and wholesale services from price cap adjustment since price cap regulation does not apply to these services.

Within the three categories, competitive services prices are not subject to a cap or ceiling. Downward pricing flexibility is permitted for all noncompetitive services, with TSLRIC as the price floor and the ceiling established at either the existing price or the upper limit for a rate band of services already in established pricing bands. Services designated as emerging competitive are permitted pricing flexibility within an established band. The price floor set by state statute is the imputation standard and the price ceiling established at the time reclassification is sought. These services are not subject to rate adjustment under a price cap formula. The price cap formula = GDPPI less 5% productivity offset less quality of service factor +/- exogenous costs. There is no low end adjustment option.

In July 2006 P.A. 06-144 was enacted which reclassified all business services and 94% of all residential local exchange services as competitive. In addition,

retail pricing changes can now be made on 5 days notice and promotions on 3 days notice. There are no price ceilings for competitive services, so the cost study requirement is eliminated for price changes; however the imputation standards applies to price floors.

The application of price cap formula requires the Telco to make revenue adjustments each year. Earnings are reported monthly and service quality exception report and semi-annual reports are required.

Illinois

In May 1992, the Illinois Public Utilities Act was modified to include an elective alternative regulation price cap plan. Illinois Bell's December 1992 petition for regulation under price caps was adopted by the Illinois Commerce Commission (ICC) in October of 1994. The plan had a five year term subject to review in 2000. Noncompetitive services were assigned to four baskets: Residential, Business, Carrier, and Other. As a result of legislation in June of 2001 (H.B. 2900), the Business Basket was eliminated with all business services and several vertical services declared competitive. Also, a Packages Basket (access line and features) and three flat rate packages were established. The ICC review extending the plan and all its provisions concluded in December of 2002 with no expiration date. The plan has no cap on earnings or sharing provisions and granted Illinois the ability to manage its own depreciation subject to ICC review. In November of 2005, Illinois Bell filed a petition for competitive classification of access lines, features, and packages in MSA-1, thereby reducing the services subject to the price cap plan. The petition was approved by the ICC in August of 2006, thereby rendering most services in Illinois designated as competitive and not subject to price caps. .

This alternative regulation plan operates by applying the change in an inflation measure of producer prices (GDPPI), a productivity factor offset of -4.3%, and any service quality penalties to the price cap index (PCI). The change in the PCI is then applied to each basket. Ten additional service quality components may be factored into the PCI should service quality fail to meet the criteria established by the Commission with eight having a penalty of -.0025 and two penalties of -.02 each. The amount of price changes by basket is determined by the application of the actual price index (API), or revenue weighted average of rates, remaining equal to or less than the PCI. Rates have been reduced under the plan each year since 1994.

Within each basket, the price for any individual rate element may not be increased more than once in any calendar year (at any time during the year). It may also not be increased by more than the percentage change in the PCI plus 2% in the annual filing. Since inflation has consistently exceeded 2% and Illinois Bell has a high productivity factor of 4.3%, there have been no price increases under the plan.

An annual alternative regulation monitoring report is required to be submitted to the ICC under the plan. The annual report consists of fourteen schedules including intrastate ratebase and earnings information. Illinois Bell also is required to submit quarterly intrastate ratebase and earnings information, monthly service quality results under the plan, the annual ARMIS 43-02 with Illinois specific accounting schedules, quarterly and annual public utility fund tax results, and cost allocation manual results.

Indiana

Regulatory reform legislation (House Enrolled Act 1279), which passed in the 2006 session of the General Assembly, deregulated nonbasic services effective March 28, 2006. The bill establishes a transition period leading to the deregulation of basic services on June 30, 2009. Basic service is defined as a stand-alone, residential access line with no discretionary services (e.g., vertical features, optional calling plan, high speed internet access, etc.). AT&T and other local exchange companies subject to Alternative Regulation Plans (ARPs) must continue to comply with the terms of their respective ARPs. AT&T's ARP terminates 6/30/07; thus AT&T may take advantage of the deregulatory portions of the bill on 7/01/07.

AT&T Indiana's current ARP was approved in June of 2004 under the terms of legislation passed in 1985, which allowed the Commission to reduce regulation on telecommunication services or companies when competition exists, when the Commission's jurisdiction produces little or no tangible benefit to customers, when regulation is unnecessary or wasteful, and when reduced regulation would best serve the public interest. AT&T's current ARP provides the Company with significant pricing flexibility through the placement of retail products into one of three tiers. Each tier is subject to a unique set of regulatory requirements, with Tier 1, basic residence and business access lines, having the greatest amount of regulatory oversight and Tier 3 having the least amount.

Under Tier 1, basic residential and business rates for customers with fewer than five lines are capped at current rates. Prices may be decreased at any time provided the lower price exceeds the service's incremental cost plus 10%. Price decreases must be filed with the Commission at least one day prior to the effective date. Cost work must be included in the package. Tier 2 services include only four stand-alone basic custom calling features and stand-alone caller ID. Rate increases for Tier 2 services are limited to $0.38 per year during the term of the ARP. Tier 3 services include all services not included in Tiers 1 and 2, including, but not limited to all new services, bundles, packages and promotions, advanced custom calling features, Centrex, intraLATA toll, directory assistance, and operator services. Price increases for Tier 3 services are not limited and are effective upon one day's notice to the Commission.

ARMIS 43-01, 43-02, 43-04, 43-05, 43-06 and 43-08 reports, the Indiana High Cost Fund Annual Report, Quarterly Infrastructure Investment Report, Operating Revenue Report for Annual Public Utility Fee, Questions Relating to Compliance with Requirements of Laws Concerning Damage to Underground Facilities (Form G-5), several Quarterly Service Quality Reports, Telephone Company Statistics (Form G-5), and the Quarterly CSO Report are required to be filed with the Commission. After the expiration of the ARP, the ARMIS reports, the Quarterly Service Quality Reports and the Quarterly CSO Report will no longer be required to be filed with IURC.

There is no Commission oversight of depreciation, no exogenous treatment and no mandatory price reductions.

Kansas

Legislation enacted in 1996 established alternative regulation which was amended in 1998, 2005 and 2006. The Kansas Regulatory Reform Plan sets price caps as the maximum price for all services, taken as a whole, in a given basket. Prices for individual services may be changed within a basket as long as the price cap index is not exceeded. A competitive sub-basket category allows for additional pricing flexibility within a competitive exchange without the necessity of maintaining averaged rates for all other customers within that same exchange, however, the sub-basket is subject to its own price cap index as well as the overall basket's price cap index. Individual Customer Pricing (ICP) is available for business service. (The ICP contract must be accompanied by a verified statement that the jurisdictional services are above long run incremental costs.) Unless approved by the Commission, no services may be priced below the price floor (LRIC and imputed access).

Services are categorized in three baskets basic local, switched access and the miscellaneous services (all other services except deregulated services). Prices may be changed up or down as long as the price cap is not exceeded and services are priced above LRIC in the basic local and miscellaneous baskets. Effective October 2003, the productivity factor in use is 3.15% for the basic local basket and 1.4% for the miscellaneous basket. The price adjustment index is GDPPI-CW less productivity plus or minus exogenous factors. Rates are capped for switched access based on January 1997 levels. Currently the price cap formula and factors are frozen until October 2008.

Statewide price deregulated services include: Long distance, operator services, Plexar® features, Auto Redial, Speed Calling and packages and bundles, offered at one price. (One price packages consist of local service with one or more call management features, long distance service[1] , internet access, video service or wireless service.) In addition, all optional and vertical services, additional

residential lines and large business (5 or more) lines in the Kansas City, Topeka and Wichita exchanges are price deregulated.

The Commission may grant price deregulation in other exchanges where it is demonstrated that two or more non-affiliated local telecommunications carriers provide local service. Of these non-affiliated carriers; one must be facilities based, one may be a wireless provider; and test must be met respectively for residential and/or business price deregulation. Once granted, all optional and vertical services, additional residential lines and large business lines will be price deregulated.

Annual financial reporting is required and service quality are reported quarterly (monthly if out of compliance) to the Commission.

Michigan

Provisions of the Michigan Telecommunications Act enacted in 1995, effectively eliminate traditional rate of return regulation. The Commission does not set access rates, however intrastate rates may not exceed the federal rates. Access rate reductions must be passed through to customers.

Revisions to the Michigan Telecommunications Act in 2005 deregulated all basic local exchange service with the exception of Primary Basic Local Exchange service, or Call Plan 100, for residential customers. Rates for all services must cover costs and cannot fall below TSLRIC. The Commission has authority to enforce certain activities such as cross-subsidy, non-discrimination, and quality of service. Copies of selected annual financial statements along with the ARMIS 43-02 USOA reports are provided annually to the Commission staff.

Missouri

The regulatory pricing plan in Missouri revolves around the competitive classification of business access lines and consumer access lines in each exchange.

Missouri law states that for a large ILEC, price cap regulation is mandatory upon the Commission's determination that a CLEC has been certified and is providing such service in any part of the large ILEC's service area. All large ILECs in Missouri are now subject to price cap regulation Under price caps, services are categorized as basic or non-basic. Maximum allowable prices for basic local and switched access services are adjusted annually by either CPI-TS, or GDP-PI minus a productivity offset formula. The law also provides flexibility to petition the PSC for an alternative way to reflect the revenue loss resulting from a negative CPI-TS adjustment in changes other than a reduction in basic local and switched access prices. Rates for non-basic services under price caps may be increased by 5% annually.

A price cap ILEC may also seek to have business and/or residential services in an exchange declared competitive, at which time the ILEC's prices for such services may rise and fall with the market. For services in exchanges classified as competitive, all services, except for switched access, offered to business and/or consumers are considered classified as competitive. An exchange is classified as competitive if two facility-based providers are providing basic local business service and/or basic local consumer service, respectively. One provider may be a wireless provider. An exchange may also be classified as competitive for business and/or consumer services based on competition from companies using their own or leased facilities unless the competitive classification is found to be contrary to the public interest.

Annual financial reporting is also required.

Nevada

Nevada's 1997 Plan of Alternative Regulation (PAR) is extended until December 2007. Under PAR rules, the four categories of services are essential – basic service, discretionary, competitive or deregulated. Essential rates are frozen and must maintain rate parity between interstate and interstate access rates. Basic service rates can be reduced without a hearing by an amount not to exceed 10% in any year. Decreases or increases for all other essential services may be implemented without a hearing if they meet certain requirements and are overall revenue neutral. Discretionary services must have minimum prices, but no longer require maximum prices, rates must not exceed TSLRIC. Market rates with no price cap can be charged for competitive services.

No filings with the Commission are required for deregulated services. Federal ARMIS 43-02 USOA and 43-08 Operational Data reports are filed with the state commission annually. Nevada is also required to file total Nevada financial operating results including the intrastate rate of return.

Ohio

Pursuant to legislation first enacted in 1988, Ohio law provides for alternative regulation of public telecommunications services. Such regulation is alternative to the traditional manner of regulating telecommunications rates and services that is set forth elsewhere in the Ohio Revised Code. Generally, authority granted to a telephone company as a result of this legislation provided greater freedom from state regulation than previously allowed. Enactment of this legislation resulted in SBC Ameritech Ohio adopting an alternative regulation plan called Advantage Ohio which it operated under from January 9, 1995 through January 9, 2003.

Sub. S.B. 235, which became effective 4/5/2001, provided the potential for additional regulatory relief by updating the definition of basic local exchange service in the Ohio Revised Code. This set the stage for regulators to modify outdated regulations for non-basic services and to establish a regulatory framework to provide incentives to Ohio's telecommunications companies to invest in new technologies and update the state's communications infrastructure. As a result, the Public Utilities Commission of Ohio ("PUCO") devised the currently available Elective Alternative Regulation Plan ("EARP"). This plan is available to any ILEC that desires to take advantage of retail services pricing flexibility for telecommunications services other than for basic local exchange services, but that is not interested in pursuing an individual company-designed plan. EARP requires Lifeline, broadband and pricing commitments in exchange for earnings freedom and pricing flexibility on non-basic and competitive services. EARP does not have an expiration date.

More specifically, EARP categorizes services as **Tier 1 Core**, which includes the primary residence and business access line and local usage, Touchtone, basic caller-id, access to 911 and OS/DA, a directory listing, per call-caller ID blocking, access to toll presubscription, IXC or toll providers or both and networks of other telephone companies; **Tier 1 Non-Core**, which includes second and third residence and business access lines, call waiting, call trace, Centrex access lines, PBX trunks, per line number ID blocking, non-pub service and N11 codes; and **Tier 2**, which includes all regulated telecommunications services that do not fall under Tier 1.

Tier 1 core services are capped for the life of the plan. Non-Core Tier 1 services are capped for the first 24 months of the plan, after which, those services are limited to a cap that is double the initial rate for the life of the plan. Tier 2 services are not subject to any rate cap and have unlimited upward pricing flexibility. Prices must not fall below the long run service incremental costs of each service plus a common cost allocation.

Additional legislation, H. B. 218, was introduced in early 2005 and Sub. H. B. 218 became effective 11-4-2005. This bill further revised state telecommunications policy, authorized the PUCO to allow alternative regulation of basic local exchange service ("BLES") and specified the scope of Commission authority regarding wholesale telecommunications services, advanced services and internet protocol-enable services. On August 7, 2006, the PUCO's BLES alternative regulation rules became effective. These new rules allow an ILEC with an approved EARP, after having complied with the required advanced services and Lifeline commitments of the EARP, to apply for alternative regulation of BLES, Basic Caller ID service and Tier 1 Non-Core services. In order to qualify for alternative regulation of BLES, Basic Caller ID service and Tier 1 Non-Core services, an ILEC must demonstrate it meets at least one of the four competitive market tests listed detailed in the rules, or a company specified competitive test, in each of the requested telephone exchange areas. In addition to the four,

Commission specified tests, the rules indicate that a company is not precluded from proposing a company specified alternative competitive market test that demonstrates the statutory competitive threshold conditions are met.

In each exchange where a competitive test is met, pricing flexibility will be granted for BLES, Basic Caller ID service and Tier 1 Non-Core services. Lifeline customers are in a safe harbor. Any BLES increases that would impact a Lifeline customer must be offset by an increase in the Lifeline discount.

AT&T Ohio, which has been operating pursuant to EARP since January 10, 2003, also obtained the PUCO's approval for BLES alternative regulation in 136 of its 192 exchanges on December 20, 2006.

Oklahoma

The Competitive Declaration plan is in effect for Oklahoma. The plan is structured with four baskets of service. The four baskets are: Basket 1 the basic local services, Basket 2 is access, Basket 3 is option services, and Basket 4 is the competitive service. On July 28, 2005, the Oklahoma Corporation Commission approved SBC Oklahoma's application to reclassify all intrastate retail telecommunication services, with the exception of switched access service, payphone access service and 911 service provided to PSAPs to Basket 4 (competitive).

Basket 4 service prices may be changed on one day's notice at the discretion of the company. The Price floor for Basket 4 is the lower of either the tariff rate as of 7/28/2005 or LRIC. The price floor for Basket 1 services is either the price charged by the company as of 6/15/2000 for LRIC plus 20%. Price increases for basic local residential service within Rate Groups 1-3 (rural) are subject to an annual limitation of $2 per line per month, once within any 12 month period until July 28, 2010.. Basket 2 rates are filed by tariff. As of 7/25/2005, there are no services in Basket 3 pursuant to PUD 200500042, Order No. 508813.

The company must maintain existing service quality standards. Annual Federal ARMIS 43-02 USOA report, 43-08 Operational Data report and a copy of the FCC Form 499A must be filed with the Commission. OCC rules also require the company to file all state-specific ARMIS report. These would include 43-01, 43-03, 43-04, 43-05, 43-06, and 43-07.

Texas

Public Utility Regulatory Act (PURA) of 2005 which incorporates amendments of Senate Bill 5, passed by the 79th Legislature is in effect in Texas.
In Texas, exchanges with populations of more than 100,000 residential access lines are deregulated. Exchanges with populations of less than 100,000 access

lines are deregulated when one CLEC is providing residential service in the exchange, one facility based provider, including cable VOIP, provides residential service in the exchange and one non-affiliated wireless provider provides service in the exchange. All business access lines are deregulated. The PUC has the ability to re-regulate an exchange with a population of less than 100,000.

The PUC-T rules require various periodic reports covering financial, construction and service quality measures. Current PUC-T rules require the submission of ARMIS reports (including all Texas specific reports).

Wisconsin

Legislation enacted in 1994 (Act 496 Alt Reg – Telecommunication Superhighway Legislation, opens LEC service to competition and allows Telcos to elect price regulation. Upon election of the regulation, a company with greater than 500,000 access lines would be required to lower its basic residential and small business rates by 10% and to place a three-year cap on the lowered rates. After three years, price increases would be limited to the rate of inflation less a 3% productivity factor, with a maximum 2% additional penalty/reward for service quality investments. A company that chooses price regulation must file a plan for infrastructure investment.

Services are placed into three categories; category 1 - price regulated local services, category 2 - access service, and category 3 - all other services. After 1997, prices in category 1 prices can be adjusted annually by the change in the GDPPI minus 3% +/- up to 2% penalty or incentive adjustment. The penalty has the effect of reducing the amount prices can be raised, primarily for poor service quality or failure to meet infrastructure investment targets. The incentive adjustment, which has the effect of increasing the amount prices can be raised, is a reward primarily for exceeding the investment targets. Prices of individual rate elements can be increased by up to 10% provided the average of all prices of price regulated services fall within price cap limits. Annual permitted price increases may be deferred and accumulated for a maximum of three years into a single increase. Competitive services are subject to pricing flexibility.

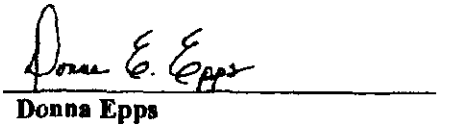
A Price Regulated company may petition the Commission to remove services from price regulation if it can demonstrate that a competitive environment exits. AT&T Wisconsin has successfully demonstrated that the following services are competitive and they are no longer price regulated: IntraLATA Toll statewide; all Small Business services statewide and all Consumer services in the 17 largest exchanges.

Annual SR based intrastate regulated earnings and return on equity (determined by SR accounting basis) is required. The PSCW Annual Report must also be filed in lieu of the ARMIS 43-01 through 43-08 schedules.

ATTACHMENT 5

Oversight after Reform

Financial Accounting Rules and Disclosures in Reporting by U.S. Public Companies



Donna Epps
Partner, Deloitte & Touche LLP

11/21/05
Date

Table of Contents

I. Introduction

Public company accounting and auditing standards are promulgated, monitored and enforced by a number of regulatory bodies. The objectives of this whitepaper are to discuss the evolution of financial accounting regulation through 2005 for U.S. public companies[1], to discuss the impact to U.S. public companies (i.e. the accounting and disclosure rules and reporting requirements) resulting from this regulation, and to identify the regulatory bodies affecting this impact through the promulgation, oversight or enforcement of regulation on public companies in today's environment.

On July 25, 2002, Congress passed the Sarbanes-Oxley Act of 2002, and President Bush signed it into law on July 30, 2002. This Act is the most comprehensive reform since the Securities Act of 1933 and the Securities Exchange Act of 1934; it covers a variety of areas, and seeks, among other things, to promote corporate responsibility, enhance public disclosure, and improve the quality and transparency of financial reporting by U.S. public companies. This legislation has a number of important implications for public companies, including their management, audit committees, independent auditors and attorneys, as well as analysts and investors.

The U.S. Securities and Exchange Commission [2] ("SEC") is the principal regulatory agency governing the U.S. securities markets and publicly traded companies. The SEC is legally charged with establishing accounting policies in the United States, but relies on private standards-setting bodies such as the Financial Accounting Standards Board ("FASB") and the Public Company Accounting Oversight Board ("PCAOB"). The SEC has empowered the FASB and PCAOB, respectively, as the authoritative accounting standard-setter and auditing standard-setter for public companies having registered securities on a U.S. national exchange.

The FASB[3] is an independent standards-setting board comprised of members from industry, the accounting profession and academia. The SEC relies on the FASB to establish Generally Accepted Accounting Principles in the United States ("U.S. GAAP") through a prescribed standard-setting process. Financial statements filed with the SEC that are not in conformity with U.S. GAAP are considered to be misleading or inaccurate, and are therefore unacceptable to the SEC.

The PCAOB[4], a private sector, non-profit corporation created by the Sarbanes-Oxley Act of 2002, replaced the American Institute of Certified Public Accountants ("AICPA"), a self-regulating body of the accounting profession, as the primary oversight of auditors of U.S. public companies.

---

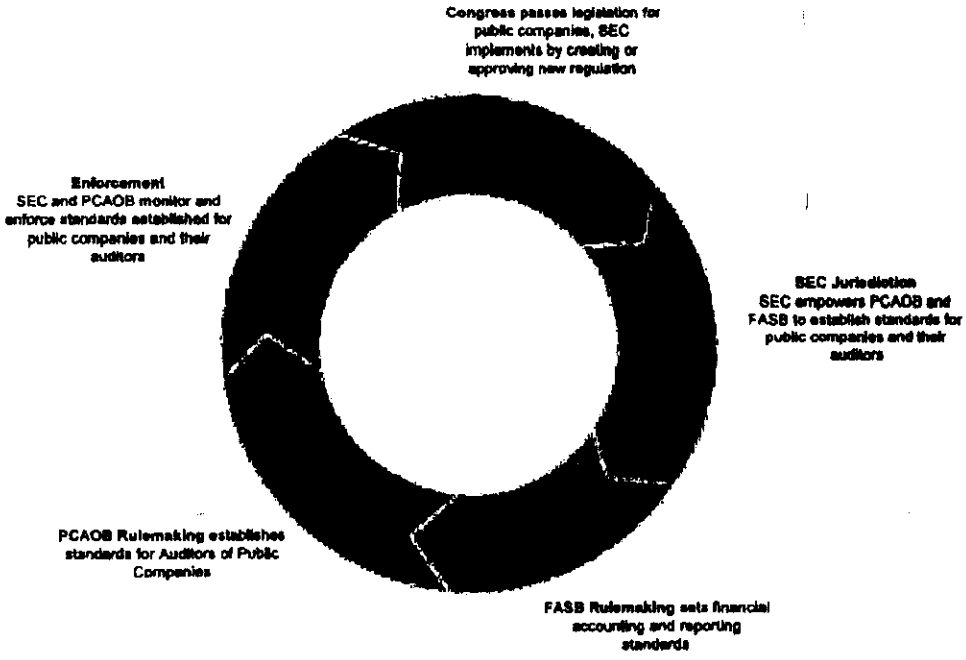
[1] A U.S. public company is defined as a company that has issued securities in an offering registered under the 1933 Securities Act or has registered the company's outstanding securities under the 1934 Securities Exchange Act requirements.

[2] For a more in-depth discussion about the SEC, see Appendix A

[3] For a more in-depth discussion about the FASB, see Appendix B

[4] For a more in-depth discussion about the PCAOB, see Appendix C

In order for the FASB's accounting and reporting rules (U.S. GAAP) to be effective as promulgated, the Sarbanes-Oxley Act of 2002 has prescribed monitoring and oversight rules for public companies and their auditors. A public company is subject to many layers of oversight both internally and externally by its internal audit department, chief executives and audit committee, as well as its external auditors, the PCAOB and the SEC. Further, the SEC and PCAOB investigate alleged infractions and enforce these accounting and auditing rules through a variety of means from penalties and fines to deregistration and imprisonment.



All U.S. public companies are subject to the federal regulations of the SEC. A U.S. public company is also subject to other federal and state regulations and statutes affecting all companies, such as Federal Trade Commission consumer protection requirements and anti-trust laws, for example.

II. Critical Milestones in Accounting Regulation [i] [ii]

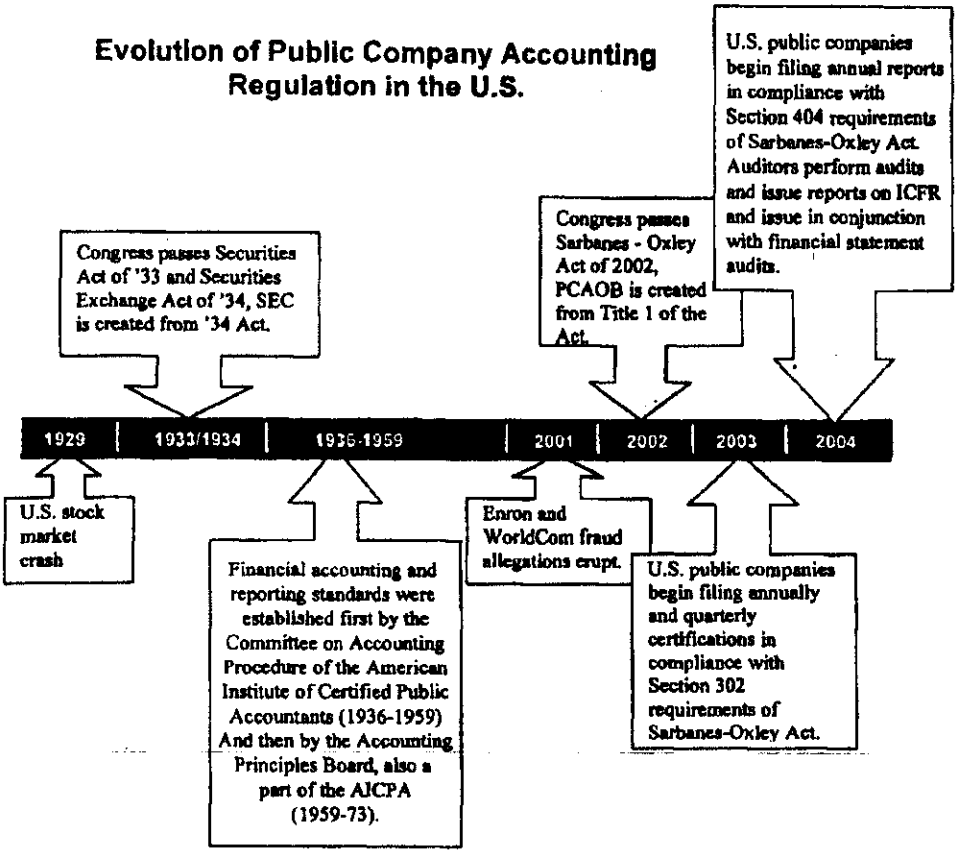
In an effort to restore public confidence and trust in the U.S. capital markets after the stock market crashed in October 1929, Congress passed the Securities Act of 1933 ("the '33 Act") and the Securities Exchange Act of 1934 ("the '34 Act"). With the passage of the '34 Act, the SEC, an independent, nonpartisan, regulatory agency, was created to provide more structure and government oversight by regulating the securities markets. The '33 Act and '34 Act place direct responsibility on officers and directors of public companies, underwriters, auditors, and attorneys for the accuracy of the financial information provided and compliance with the securities laws and regulations.

On July 25, 2002, Congress passed the Sarbanes-Oxley Act of 2002, and President Bush signed it into law on July 30, 2002. The Act represents a major development in the push to reform corporate accountability in the U.S. Broadly, the legislation addresses corporate reform in light of a series of business failures and corporate scandals that began with Enron in 2001. More specifically, the Act covers a variety of areas and seeks, among other things, to promote corporate responsibility, enhance public disclosure, improve the quality and transparency of financial reporting, create the PCAOB to oversee the accounting profession, protect the objectivity of research analysts, and strengthen penalties for violations of securities law. This legislation has a number of important implications for both public companies and their independent auditors.

The most significant change brought about by the Sarbanes-Oxley Act is its emphasis on the effectiveness of a public company's systems of internal controls. Effective internal controls are fundamental to investor confidence in financial reporting because they help to deter fraud and to prevent inaccurate financial statements. Under the Sarbanes-Oxley Act, U.S. public companies are now subject to new requirements for management and independent auditors to assess, document and report on the effectiveness of Internal Control over Financial Reporting ("ICFR"). Prior to the Sarbanes-Oxley Act, management was not required to formally assess and document their internal controls, and was only required to report material weaknesses found in the course of an audit to their audit committee. Furthermore, independent auditors were required to assess internal controls only to the extent it was required in order to plan their audit.

The most visible change of the Sarbanes-Oxley Act is the inclusion of new reports and certifications in public filings with the SEC by company management on their assessment of the effectiveness of the company's ICFR, and supplemental opinions included in the independent auditor's report on the company's external financial statements; these additions include, the auditor's opinions on management's assessment on ICFR, and on the effectiveness of the company's ICFR.

Evolution of Public Company Accounting Regulation in the U.S.



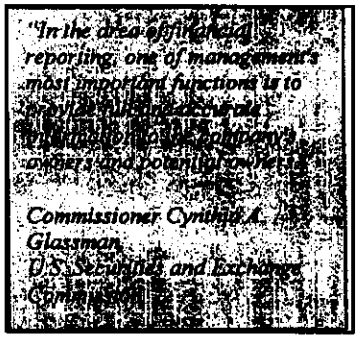
III. U.S. Public Company Financial Accounting Rules and Disclosures in Reporting

U.S. public companies are required to present their financial statements in conformity with accounting principles generally accepted in the United States of America, collectively referred to as U.S. GAAP. Financial statements are defined herein to include the balance sheet, statement of income, statement of shareholders' equity, statement of changes in cash flows, and the explanatory notes to these statements.

A. Financial Statements in Conformity with U.S Generally Accepted Accounting Principles ("U.S. GAAP")

The overall accuracy of the financial statements, including interim financial information, and their conformity with U.S. GAAP is the responsibility of the company's management. In this regard, management has the responsibility for, among other things:

- Establishing and maintaining effective internal control over financial reporting
- Identifying and ensuring that the company complies with the laws and regulations applicable to its activities
- Presenting financial statements that are in conformity with U.S. GAAP and adjusting the financial statements to correct any material misstatements



B. U.S. GAAP

U.S. GAAP establishes rules around the recording, reporting and disclosing of transactions by companies. By requiring that all companies present their financial statements in accordance with GAAP, consistency and standardization in presentation is improved, and misinterpretation by readers of financial statement is reduced. U.S. GAAP includes, for example, a number of pronouncements related to each of the following: [5]

- Revenue recognition disclosure, timing and measurement
- Related party transaction valuation and disclosure
- Estimations of accruals, indirect cost allocations, etc.
- Impairment and restructuring charges
- Business combinations, goodwill and other intangible assets (FAS 141 / 142)
- Segment reporting (reporting disaggregated information by geographic, division, industry/product, or distinction used internally by management in decision-making)
- Other than temporary impairment
- Loss contingencies

[5] For a detailed list of GAAP pronouncements, see Appendix D

Current U.S. GAAP comprises over 2,000 pronouncements issued by different organizations – the FASB, the Emerging Issues Task Force ("EITF"), the Accounting Principles Board (APB) created by the FASB, the Accounting Standards Executive Committee (AcSEC) of the AIPCA, and the SEC in a variety of forms.

While the SEC has the statutory authority to prescribe accounting and reporting principles for public companies, it has allowed the standard-setting bodies designated by the accounting profession to provide leadership in establishing and improving the accounting principles. The SEC has declared the FASB as the authoritative standard setter in establishing U.S. GAAP.[6] [iii] Due to the number of entities that have historically contributed to the creation of these accounting principles, the accounting profession has followed an established hierarchy for the various sources of authoritative accounting pronouncements in the United States.

The current GAAP hierarchy is organized as follows:[iv]

Level A FASB Statements, FASB Interpretations, APB Opinions, Accounting Research Bulletins ("ARBs"), SEC Staff Accounting Bulletins ("SABs") [7]
Level B FASB Technical Bulletins, AICPA Industry Guides, AICPA Statements of Position ("SOPs")
Level C EITF Consensuses, AICPA AcSEC Practice Bulletins
Level D FASB Staff Implementation Guides, Derivatives Implementation Group Consensuses, FASB Staff Positions, FASB Concepts Statements, AICPA Issues Papers

If the accounting treatment for a transaction or event is not specified by a pronouncement in Level A, a company should consider whether the accounting treatment is specified by an accounting principle from a source in Levels B-D, and should follow the accounting treatment specified by the accounting principle from the source in the highest level, for example, follow level B treatment over level D [v].

A company cannot represent that its financial statements are presented in accordance with U.S. GAAP if its selection of accounting principles departs from the U.S. GAAP hierarchy and that departure has a material impact on its financial statements. [vi]

[6] For a more in-depth discussion of the FASB, see Appendix B: FASB.
[7] For a detailed list of Level A U.S. GAAP accounting rules, see Appendix D.

IV. U.S. Public Company Internal Controls Over Financial Reporting ("ICFR") Rules

A. Sarbanes-Oxley Act of 2002 [8]

From the Sarbanes-Oxley Act came a series of rules for assessing the effectiveness of a public company's internal controls in order to fulfill the Act's mandate for reform - to enhance corporate responsibility, enhance financial disclosures and combat corporate and accounting fraud. This reform has impacted the financial reporting process, and the systems, policies and procedures underlying it, for U.S. public companies.

Under the Sarbanes-Oxley Act, U.S. public companies are now subject to new requirements for management and independent auditors to assess, document and report on the effectiveness of ICFR. Prior to the Sarbanes-Oxley Act, management was not required to formally assess and document their internal controls, and was only required to report material weaknesses found in the course of an audit to their audit committee. Furthermore, independent auditors were required to assess internal controls only to the extent it was required in order to plan their audit.

Importance of Internal Controls
PCAOB adopted Auditing Standard No. 2 "An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements" states that management's assessment of the effectiveness of its internal control over financial reporting must be based on a suitable, recognized control framework that has been established by a body of experts. In the United States, the most broadly accepted framework is that created by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), and it is used by the large majority of U.S. companies. The SEC has stated that the COSO framework satisfies its criteria, but it has not mandated its use.[9]

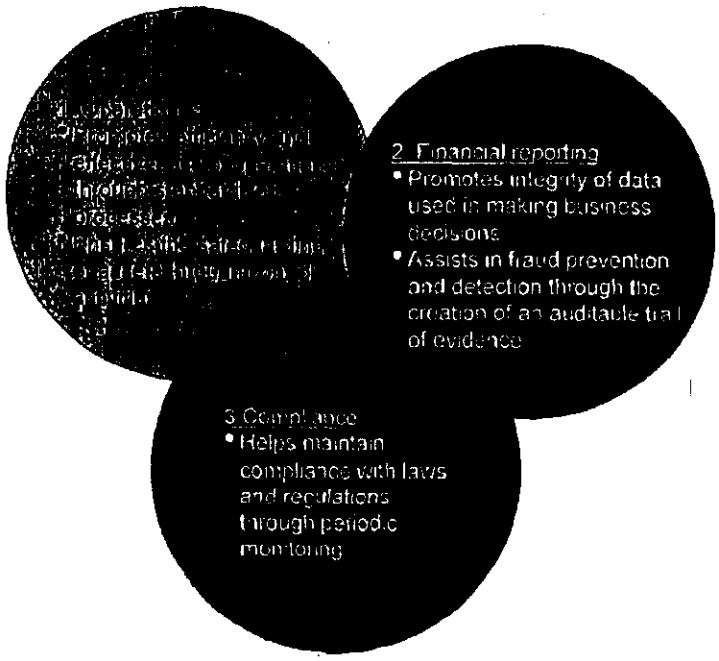
COSO defines internal control as a process implemented by a company's board of directors, management, and other personnel that is designed to provide reasonable assurance that an organization can achieve its objectives in three interrelated areas:

1. Effective and efficient operations
2. Reliable financial reporting
3. Compliance with applicable laws and regulations

Reliable financial reporting is dependent, in part, on the achievement of the other objectives and vice versa. Section 404 of the Sarbanes-Oxley Act relates to the internal control objective of reliable financial reporting, and requires public company management to design and implement a system of internal control over financial

[8] For a list and detailed description of the Sarbanes-Oxley Act by Title, see Appendix E.
[9] For a more in-depth discussion of the COSO framework adopted by the majority of U.S. public companies, see Appendix F.

reporting; evaluate the effectiveness of the company's internal control over financial reporting and provide a public report on that assessment.



The COSO framework presents five related components of internal control:

- Control environment
- Risk assessment
- Control activities
- Information and communication
- Monitoring controls

PCAOB adopted Auditing Standard No. 2 requires that company management:

- Accept responsibility for the effectiveness of the Company's internal control over financial reporting
- Evaluate the effectiveness of the Company's internal control over financial reporting using suitable control criteria (e.g., the COSO framework)
- Support its evaluation with sufficient evidence, including documentation
- Present a written assessment of the effectiveness of the Company's internal control over financial reporting as of the year end date under audit.